

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

North Shore Gas Company	:	
and	:	
The People Gas Light and Coke Company	:	
	:	09-0436
Petitions Pursuant to Rider EEP of	:	09-0437
Schedule of Rates for Gas Service to	:	(Cons.)
Initiate a Proceeding to Determine the	:	
Accuracy of the Rider EEP Reconciliation	:	
Statement	:	

ORDER

By the Commission:

I. PROCEDURAL HISTORY

In the final Order in 2007 rate increase proceedings concerning Petitioners, North Shore Gas Company (“North Shore” or “NS”) and The Peoples Gas Light and Coke Company (“Peoples Gas” or “PGL”) (collectively, the “Utilities” or “NS-PGL”)¹, the Illinois Commerce Commission approved Rider EEP, Enhanced Efficiency Program, for both companies. Rider EEP became effective February 14, 2008.

Section C of Rider EEP requires in part that commencing in 2009, North Shore and Peoples Gas “shall also file annually with the Commission, no later than September 30, an EEP statement of activity, including program descriptions, for the Previous Program Period and a report showing the determination of the Reconciliation Adjustment to be in effect during the Reconciliation Period.”² Section C of Rider EEP also requires the Utilities to file a petition with the Commission seeking initiation of an annual reconciliation to determine the accuracy of the reconciliation statement.

On September 30, 2009, the Utilities each filed the requisite EEP Statement of Activity and Statement of Reconciliation Adjustment, showing the program descriptions and determination of the Reconciliation Adjustment (“RA”) for the applicable period, May 1, 2008 through June 30, 2009. The Utilities also each filed the necessary “Petition to Initiate Docket,” requesting proceedings determining the accuracy of the Reconciliation Adjustment. The instant Dockets ensued.

¹ North Shore Gas Co., et al., Dockets 07-0241 & 07-0242 (consol.), Order Feb. 5, 2008 (“2007 Rate Order”).

² Ill. C. C. No. 17, Third Revised Sheet No. 55, Section C (North Shore Rider EEP); Ill. C. C. No. 28, Fourth Revised Sheet No. 56, Section C (Peoples Gas Rider EEP).

Pursuant to notice given as required by law and the rules and regulations of the Commission, hearings in these dockets were convened at the Commission's offices in Chicago, Illinois on October 27, 2009, February 2, 2010, June 22, 2010 and September 14, 2010, before a duly authorized Administrative Law Judge ("ALJ") of the Commission. At the October 27, 2009 hearing, the ALJ ordered the consolidation of the instant Dockets. Counsel entered appearances in the consolidated cases on behalf of the Utilities, ICC Staff ("Staff"), and the Office of the Attorney General of the State of Illinois ("AG").

At the September 14, 2010 hearing, the following witnesses testified on behalf of the Utilities: Edward M. Korenchan, the Utilities' Coordinator, Rates; Patrick E. Michalkiewicz, the Utilities' Manager, Energy Efficiency & Public Benefits; James Schott, the Utilities' Vice President, External Affairs; Annette Beitel, President of Future Energy Enterprises, LLC; and John Plunkett, President, Green Energy Economics Group, Inc. The following witnesses testified on behalf of Staff: Dianna Hathhorn, an accountant in the Accounting Department of Staff's Financial Analysis Division; and David Brightwell, an economic analyst in the Policy Program of the Energy Division of the Commission.

By ruling on September, 2010, the ALJ granted in part and denied in part Staff's motion to strike certain lines of the Utilities' rebuttal testimony.

The Utilities and Staff each filed a post-hearing Initial Brief ("IB") on October 20, 2010. The AG filed a post-hearing IB on October 21, 2010. Per order of the ALJ, the Utilities filed a draft Proposed Order limited to uncontested issues on October 26, 2010. The Utilities, Staff, and the AG each filed a Reply Brief ("RB") on November 10, 2010.

The ALJ filed and served a Proposed Order on December 9, 2010. On January 12, 2011, the Utilities and Staff each filed a Brief on Exceptions ("BOE"), which included specific replacement language for the final Order, as Commission rules require. Staff, the Utilities and the AG each filed a Reply Brief on Exceptions ("RBOE") on February 9, 2011. The Utilities filed a supplement to their BOE on February 10, 2011, to provide a computation based upon matter contained in the evidentiary record.

The record was marked heard and taken on February 15, 2011.

II. UNCONTESTED ISSUES

A. Statements of Activity

As already noted, each Rider EEP requires the utility to submit a statement of activity for the applicable period³. The applicable period in these consolidated dockets is May 1, 2008, through June 30, 2009⁴. Mr. Michalkiewicz presented the Rider EEP

³ NS Ex. 2.0 at 4; PGL Ex. 2.0 at 4.

⁴ NS Ex. 1.0 at 3; PGL Ex. 1.0 at 3.

Statement of Activity for each of the Utilities for that period. The Statements contain detailed descriptions of the Chicagoland Natural Gas Savings Program (“Chicagoland Program” or “Program”) and its portfolio of energy efficiency measures for the period, including: 1) measures implemented to achieve energy efficiency goals; 2) the performance modeling and cost effectiveness calculator used to screen individual energy efficiency measures and establish the overall program cost effectiveness; 3) community outreach and education efforts; 4) program contract administration; 5) expenses; and 6) goals and performance metrics⁵.

Staff witness Ms. Hathhorn reviewed the Statements of Activity and identified no concerns with them, other than referencing the adjustments proposed by Staff witness Dr. Brightwell, discussed later in this Order.

The Commission finds that the Utilities complied with the Rider EEP requirement to file statements of activity for the applicable period.

B. Statement of Reconciliation Adjustment

Rider EEP calls for the Utilities to file certain charges (the “Effective Component”) with the Commission each year. The Effective Component is a monthly per-customer charge based on the Annual Program Budget approved by the Commission in the utility’s most recent rate case. Rider EEP is applicable to Service Classifications (“SC”) 1 (Small Residential Service) and 2 (General Service), and there is a separate Effective Component for each SC.

Mr. Korenchan presented the Rider EEP Statement of Reconciliation Adjustment for both North Shore and Peoples Gas for the applicable period. The Statements explain how the RA’s were calculated for each applicable SC. The following information was included in the RA calculations: 1) the Carry-Over Budget Amount; 2) the Total RA dollar amounts, including Carry Over amount and applicable Interest; and 3) the monthly per-customer RA.

Staff witness Hathhorn reviewed the Utilities’ Statements of Reconciliation Adjustment. She recommends that the Commission accept the reconciliations of SC No. 2 as filed and accept the reconciliations of SC 1 (with the adjustments proposed by Staff witness Brightwell).

There is no dispute over the accuracy of the Utilities’ accounting for their costs and revenues under the riders and the RAs. The Commission finds that the Utilities correctly accounted for their costs and revenues under the riders and the RAs during the applicable period. We accept the Statements of Reconciliation Adjustment, subject to the discussion of Staff’s contested proposed adjustments (which apply only to SC 1) discussed later in this Order. We find that the Utilities complied with Rider EEP as to required reports regarding the reconciliation statements for the applicable period.

⁵ NS Ex. 2.1; PGL Ex. 2.1.

III. CONTESTED ISSUES

In the Chicagoland Program, the Utilities offered customer rebates for selected energy efficiency measures: furnaces; boilers; water heaters; clothes washers; wall insulation; and ceiling insulation. Staff contends that it was imprudent to include three of those - water heaters, clothes washers and wall insulation - in the rebate scheme. In Staff's view, it was apparent, before the Program launched, that none of those measures would provide net economic benefit to customers. Staff recommends, therefore, that NS-PGL be barred from recovering *any* rebates distributed for those measures. The Utilities reply that they were not responsible for the selection of those measures and that, even if they were, such selection was prudent under principles previously enunciated by this Commission. Moreover, the Utilities aver, insofar as such selection may be deemed imprudent, any disallowance should be limited to the incremental dollar amount associated with imprudence. The AG asserts that while the Utilities can and must be responsible for imprudence in Program implementation, there was no imprudence in this instance.

A. Whether and to What Extent the Board's Program Decisions May Be Attributed to the Utilities for Cost Recovery Purposes

The Utilities' first line of defense against Staff's imprudence claim is that they cannot and should not be held responsible for decisions made by the Program's Governance Board. The context for this argument (which the Utilities present in various permutations) arises from two previous Commission decisions. First, during merger proceedings involving the Utilities⁶, several parties (including the Utilities and the AG) entered into a Memorandum of Agreement ("MOA") containing resolutions of all contested issues among those parties. In the MOA, the Utilities agreed (among other things) to propose in their expected 2007 rate cases one or more energy efficiency programs, with an aggregate annual spending level of \$7.5 million, a third-party administrator, a mechanism for program cost recovery and no Utility funding beyond the amount of Commission-allowed cost recovery in the rate cases⁷. Although not a party to the MOA, Staff signed it to memorialize that it did not oppose the MOA⁸. The Commission approved the MOA, and required its implementation⁹.

Second, in their 2007 rate cases, pursuant to the WPS Order and post-Order discussions with the MOA parties, the Utilities proposed what is now the Chicagoland Program, which included an independent Governance Board with five voting members¹⁰, an independent Contract Administrator, an independent Program Administrator and an independent Program Evaluator. The Utilities also proposed cost-recovery riders. Staff opposed the proposed energy efficiency program on both

⁶ WPS Resources Corp., et al., Docket 06-0540, Order, Feb. 7, 2007 ("WPS Order").

⁷ *Id.* at 24.

⁸ *Id.* at 3.

⁹ *Id.* at 23-25 & Appendix A, Conditions 27-30.

¹⁰ The AG, the Utilities, the City of Chicago, the Citizens Utility Board and the Environmental Law & Policy Center (plus Staff as a non-voting member).

conceptual and practical grounds¹¹. The Commission rejected Staff's foundational objections, but approved its proposed administrative cost cap and its suggested textual revisions for the riders, which the Utilities did not oppose¹². We also adopted Staff's recommendation of an annual cost reconciliation procedure (from which the instant docket emanates). An annual reconciliation, the Commission declared, would "ensure that ratepayers are only charged for the actual costs of the energy efficiency program *prudently incurred*."¹³

In light of the foregoing decisions, NS-PGL maintains that application of the 2007 Rate Order prudence standard must recognize the relationship between the Utilities and the Governance Board. They stress that the Board (on which the Utilities have only one of five votes) selects the efficiency measures in the Program, with NS-PGL merely implementing the Board's choices. Therefore, NS-PGL avers, our review should be confined to the prudence of, first, the Utilities' proposal to have efficiency measures selected by an independent board and, second, the mechanics of the Utilities' implementation of Board decisions (e.g., contract administration, rebate payment and potential misappropriation of funds)¹⁴.

Taking the first prong of the Utilities' argument at face value, the Commission readily rejects it. The efficacy of an independent governing board was determined in the 2007 Rate Order. We never intended for that question to be re-litigated annually in reconciliation proceedings. Rather, as our Order stated, the purpose of reconciliation is to review "actual costs" incurred for energy efficiency.

The finer point the Utilities are presumably making is that our approval of the Governance Board predetermined the prudence of any policy choices made by that entity. Indeed, they assert that "[t]he very creation and selection of that Board established prudence as to Board decisions."¹⁵ That was not the Commission's intention, however. While we certainly anticipated that the inclusion of multiple stakeholders on the Board would minimize administrative litigation, we did not mean to pre-endorse any energy efficiency decisions the Board might make. Even experts, acting in good faith, can make imprudent choices. That is why the General Assembly empowered the Commission to assess the prudence of, for example, utility fuel purchases and plant additions, despite the presumed expertise of the utility employees, consultants and contractors conducting those activities. Simply put, expertise is not a shield. Moreover, had the Commission intended to remove the prudence of the Governance Board's decisions from annual reconciliations, thereby withdrawing our oversight of the resulting expenditures of ratepayer funds (except for malfeasance, which we distinguish from prudence in any event), we would have said so.

¹¹ 2007 Rate Order at 167-170.

¹² *Id.* at 183-184.

¹³ *Id.* at 184 (emphasis added).

¹⁴ NS-PGL RB at 5-6.

¹⁵ NS-PGL IB at 14.

With respect to the second prong of NS-PGL's argument, the Utilities correctly state that they cannot unilaterally select energy efficiency measures and, in theory, might even oppose an efficiency measure yet still be obliged to implement it if a Board majority so desired¹⁶. Essentially, the Utilities frame a fairness issue - is it fair to hold them accountable for effectuating choices they cannot control? The answer is yes. NS-PGL voluntarily proposed ceding control of their energy efficiency portfolio to an independent board. They surrendered control in order to assure customers and regulators that they would not obstruct a program intended to reduce consumption of the gas products they sell¹⁷. With that volitional trade-off, they gave up hands-on control of energy efficiency choices and elected to rely on the Governance Board's performance, for better or worse. Furthermore, the Utilities cannot trade away legal responsibility. They are obliged to expend ratepayer-supplied funds prudently and charge just and reasonable rates¹⁸.

Additionally, the decision to rely on the performance of the Governance Board is not legally or functionally different from many decisions utilities make. Through contracts, partnerships and other business arrangements, they cede direct control of necessary processes and services to others. There are various reasons, including legal obligation, practical necessity or a preference for outsourcing tasks or expenses. For example, corporate books are reviewed and certified by independent accountants. Independent pipelines deliver natural gas to utility facilities. Independent financial entities provide advice and manage capital generation. Equipment and parts are supplied by independent vendors. In all of those instances, during prudence review, the utility, not the independent party, must defend the impact of decisions made.

In their Exceptions, the Utilities resist the foregoing comparison between the Governance Board and, on the other hand, "contracts, partnerships, outsourcing and other business arrangements." In the latter case, NS-PGL emphasizes, there are "contractual and other legal rights which hold [the other] parties accountable" to the Utilities.¹⁹ That argument is unpersuasive. The Utilities cannot choose to surrender the accountability they require in other business arrangements, then use that absence of accountability to avoid responsibility when there is imprudent use of ratepayer funds. That should be especially clear to managers of publicly regulated entities that are not free, under applicable statutes, to create an accountability vacuum. Moreover, NS-PGL's "contractual and other legal rights" vis-à-vis other business entities do not preclude regulatory disallowances²⁰.

¹⁶ As subsequent analysis in this Order demonstrates, this hypothetical scenario did not, in fact, occur. The Utilities participated in and approved the relevant actions of the Governance Board.

¹⁷ 2007 Rate Order at 163-64.

¹⁸ 220 ILCS 5/9-101.

¹⁹ NSG-PG BOE at 5.

²⁰ For example, a utility's right to sue a defaulting vendor for damages is distinct from the Commission's authority to disallow recovery of utility expenses caused by, say, the imprudent selection of an unqualified vendor.

In sum, the decisions and actions of the Governance Board are attributable to NS-PGL for the purpose of determining the prudence of the selection of energy efficiency measures for the Chicagoland Program.

B. Deference to Decisions of the Program's Independent Governance Board

Since we conclude that the Utilities' bear responsibility for the prudence of the Governance Board's energy efficiency decisions, NS-PGL recommends that the Commission accord "deference" to the Board's selections²¹. What constitutes deference is not explicitly stated, but we infer from the Utilities' briefings that, in view of the expertise, diligence and neutrality of the Board, its chosen energy efficiency portfolio should be deemed prudent (with the burden of proving otherwise placed on others). The Commission does not doubt the wisdom, effort and fairness of the Board. Their representatives, constituent organizations and consultants were well-qualified for creating and conducting an energy efficiency program. But, as the Commission observed above, the Commission's assigned role is to evaluate the work of experts, not to defer to it. The public utilities universe is heavily populated by persons with expertise, and if the Commission reflexively deferred to expertise, it would abandon its regulatory responsibility.

In its Exceptions, the AG suggests giving "weight" to the Governance Board's energy efficiency choices, in recognition of the varied interests that make up the Board²². The Commission perceives a distinction between "weight" and "deference," with the latter connoting abdication of the Commission's statutory duty, while the former merely involves putting evidence in its appropriate context (something the Commission endeavors to do in any case). Accordingly, we do assign considerable weight to the expertise and diversity of the Board throughout this Order.

C. Prudence Defined

The parties essentially agree about the attributes of prudence under the Public Utilities Act. Prudence is the standard of care that a reasonable person would exercise under the same circumstances encountered by utility management at the time decisions had to be made. Hindsight review is impermissible and imprudence cannot be sustained by substituting one's judgment for that of another. Reasonable persons can have honest differences of opinion without either necessarily being imprudent. The Commission has applied these principles before²³ and will do so here²⁴.

²¹ NGL-NS IB at 12-14.

²² AG RBOE at 6.

²³ *E.g., Illinois Power Co. v. Illinois Commerce Comm'n*, 339 Ill. App. 3d 425, 790 N.E.2d 377 (5th Dist. 2003), cited in NS-PGL IB at 2.

²⁴ Curiously, the Utilities argue that applying the prudence standard is equivalent to affording deference to the Governance Board. NS-PGL Exceptions at 10-11. We disagree. The prudence standard involves the absence of hindsight and the acceptance of reasonable, but not necessarily optimal, decision-making. Deference involves a presumption of prudence, attributable to the identity of the decision-maker.

D. Measuring Prudence - the TRC and the PAC

The parties agree that, in this instance, cost-effectiveness is a principle attribute of prudence, one that can be *quantitatively* measured by comparing the costs and benefits associated with the Program's energy efficiency efforts²⁵. Two quantitative mechanisms for measuring cost-effectiveness are involved here - the Total Resource Cost ("TRC") test and the Program Administrator Cost ("PAC") test. The TRC is a benefit-cost test, in which a ratio greater than 1-1 indicates quantitative benefit. Staff witness Brightwell describes it in greater detail:

The TRC estimates incremental costs for both the utility and the customer installing the [energy efficiency] measure. It then compares it to the incremental avoided costs for both the customer and the utility to determine the savings. It essentially estimates the private benefits of all savings to the costs to all parties that are necessary to achieve those savings. If the TRC is above 1, it means that the benefits that accrue to all parties exceed the costs that accrue to all parties²⁶.

The PAC test, according to NS-PGL witness Plunkett, tallies only the costs of efficiency investments incurred by program administrators and supported by ratepayers (here, the rebates paid to Program participants), and only the benefit of avoided gas costs. It does not include the value of non-gas resources in the calculation of benefits (e.g., the avoided cost of other resources, such as electricity and water, attributable to the efficiency measures in the Program), nor does it include customers' contributions toward efficiency investments in the calculation of costs (e.g., the customer's cost of buying or installing efficiency products)²⁷.

All parties agree that it was reasonable to measure the cost-effectiveness of the Utilities' efficiency measures with the TRC. However, there is conflict about use of the PAC. Staff maintains that the TRC test is "a better criterion than the PAC to determine if an expenditure is prudent," principally because it includes more components and interests in the analysis²⁸. The Utilities assert that neither test is sufficient by itself, principally because the TRC focuses broadly on societal costs, while the PAC more narrowly observes ratepayers' costs²⁹. The Utilities aver that the Governance Board used both tests when shaping the Program's energy efficiency portfolio.

²⁵ The parties disagree, however, with respect to the addition of *qualitative* factors, such as customer comfort, in the prudence analysis here.

²⁶ Staff Ex. 2.0 at 8. Incremental costs include the cost of equipment and labor, and represent only those costs that are incremental (additional) to the costs of a baseline piece of equipment or standard. Incremental benefits are the present value of savings over the lifetime of the efficiency measure (again, incremental to the benefits associated with baseline equipment or standards). NS-PGL Ex. 2.0 at 6.

²⁷ NS-PGL Ex. 5.0 at 12.

²⁸ Staff Ex. 2.0 at 8.

²⁹ NS-PGL Ex. 5.0 at 11-12.

The Board began designing the Chicagoland Program in late October 2008³⁰. Before then, the Commission had decided two energy efficiency cases in which only the TRC test was applied³¹. However, those dockets were governed by a statute pertaining only to electric energy (effective as of August 2007) that mandated application of the TRC³². The prudence of utilizing the PAC test was never an issue in those proceedings. Consequently, the Commission did not rule out application of the PAC in late 2008 (and did not do so thereafter). Today, there is a statute requiring the TRC test for measuring the cost-effectiveness of energy efficiency for natural gas³³. That statute took effect in July 2009. Therefore, the Utilities contravened no statute or Commission Order by employing the PAC test in October 2008.

The remaining question, then, is whether use of the PAC (here, in conjunction with the TRC) was, for some *other* reason, generally unreasonable or beneath the standard of care expected of an energy efficiency manager in late 2008. The Commission cannot reach that conclusion. NS-PGL witness Plunkett stated that the PAC has been utilized for evaluating cost-effectiveness in energy efficiency programs outside Illinois³⁴. Staff witness Brightwell does not refute that point, emphasizing instead the conceptual differences between the tests. Indeed, he considers the PAC useful for determining rebate levels once an energy efficiency measure has passed the TRC test³⁵. Thus, it was not generally imprudent to apply the PAC test here, although its application in this specific instance could have been imprudent, depending upon its manner of use and the reliance placed upon it (discussed later in this Order).

E. Whether Prudence Should Be Assessed Only at the Portfolio Level

Staff avers that “the heart of this dispute...is whether individual measures must meet a cost[-]effectiveness standard or whether it is only necessary for a portfolio as a whole to be cost effective, regardless of whether some measures do not meet the standard.”³⁶ Staff insists that cost-effectiveness must be evaluated at the efficiency *measure* level. “If a particular measure is not cost-effective under the TRC then it does not have sufficient value to society to make it worthwhile to incent. Every unit sold of a measure that is not cost effective serves to reduce the net benefit of the program.”³⁷ Moreover, Staff argues, “portfolio level cost effectiveness calculations [have] more uncertainties than the measure level TRC test calculations...The program can mitigate the risk of uncertainty around their forecasted rebates for each measure by only

³⁰ NS-PGL Ex. 4.0 at 9.

³¹ Commonwealth Edison Co., Dckt. 07-0540, Order, Feb. 6, 2008 (“ComEd Electric Efficiency Docket”); Ameren CILCO, et al., Dckt. 07-0539, Order, Feb. 6, 2008 (“Ameren Electric Efficiency Docket”). The principles and conclusions in the two Orders are virtually identical.

³² 220 ILCS 5/8-103.

³³ 220 ILCS 5/8-104. That statute took effect ten days after the end of the reconciliation period in this case. Thus, while the import of the PAC in future reconciliation proceedings need not be determined at this time, it is certain that the TRC test will have to be employed as the statute requires.

³⁴ NS-PGL Ex. 5.0 at 15; NS-PGL Ex. 7.0 at 5-6.

³⁵ Staff Ex. 3.0 at 5.

³⁶ Staff IB at 8.

³⁷ *Id.* at 13.

including measures with a TRC ratio greater than 1.”³⁸ Staff adds that there was “no reference” to portfolio-level assessment of energy efficiency plans in a gas-related Order we issued shortly before development of the Chicagoland Program³⁹.

In contrast, the Utilities and the AG support portfolio-level analysis. The Utilities argue that “the portfolio-base[d] approach allows for a broad range in products in various stages of market penetration/maturity which reduces lost opportunities, maximizes consumer exposure to efficiency, and helps to transform markets by building demand and therefore increasing cost effectiveness of lower penetration products.”⁴⁰ Utilities witness Plunkett characterizes portfolio-level measurement as a “standard approach” that produces the most cost-effective energy savings “over time.”⁴¹ The AG asserts that adoption of Staff’s measure-level approach would discourage measures “that generate long-term interest in efficiency by both buyers and sellers of energy efficiency products - programs that may be deemed non[-]cost-effective in the short term, such as school-age education programs.”⁴² The AG and NS-PGL both emphasize that portfolio-level measurement was approved in the ComEd Electric Efficiency Docket and the Ameren Electric Efficiency Docket⁴³, and the Utilities emphasize that portfolio-level assessment was never addressed in the Ameren Gas Efficiency Docket⁴⁴.

It is unnecessary for the Commission to re-visit here the merits of measure-level prudence versus portfolio-level prudence, because we agree with the Utilities and the AG that we did not hold or imply in the Ameren Gas Efficiency Docket that measure-level assessment of an efficiency program is required or that portfolio-level assessment is imprudent. The Ameren Companies chose to apply the TRC test at three levels - measure, program⁴⁵ and portfolio - and we considered each of those steps. There was no dispute about TRC application at any level⁴⁶. We merely evaluated what the Ameren Companies presented. The Commission did not mention - much less rescind - our approval of portfolio-level measurement in the ComEd Electric Efficiency Docket and the Ameren Electric Efficiency Docket. It does not matter, as Staff suggests, that the latter dockets concerned electric utilities, while the Ameren Gas Efficiency Docket dealt with a gas utility. Indeed, we stated in the ComEd case that TRC calculation “at the portfolio level provides *utilities* with greater flexibility to assure that measures with less

³⁸ *Id.*

³⁹ *Id.* at 10, citing Ameren CILCO, et al., Dckt. 08-0104, Order, Oct. 15, 2008 (“Ameren Gas Efficiency Docket”). Staff’s assertion is incorrect, however. Our Order states, at 17, that “the cost-effectiveness of the portfolio as a whole was tested using the TRC test, once the portfolio composition was fixed and portfolio-wide costs were added.”

⁴⁰ NGL-NS IB at 18.

⁴¹ NGL-NS Ex. 5.0 at 14.

⁴² AG RB at 6.

⁴³ NGL-NS IB at 18; AG IB at 16.

⁴⁴ NGL-NS RB at 9.

⁴⁵ In the Ameren Gas Efficiency Docket, at 11, we considered a “program” to be a group of measures “targeted at a specific market,” as when insulation and infiltration reduction measures are bundled in a home performance program. All of Ameren’s programs constituted its “portfolio.” *Id.* at 11.

⁴⁶ Thus, Staff did not object to, or challenge the imprudence of, the Ameren Companies’ program-level or portfolio-level analyses.

short-term energy savings value, but greater value over several years, will be included in any overall portfolio of measures and programs.”⁴⁷

It therefore follows that the Governance Board could justifiably employ portfolio-level measurement in reliance on our Order in the ComEd Electric Efficiency Docket and the Ameren Electric Efficiency Docket. That is, the Board was not, in general, imprudent because it did so. Nor was the Board imprudent, as Staff asserts, because it contradicted any directive in the Utilities’ 2007 Rate Order. There is no contradiction. Although Staff is certainly correct that we said there that “the selection of appropriate, cost-effective efficiency *measures*...will make a significant positive contribution to the benefit of all ratepayers,”⁴⁸ the Commission was not distinguishing measures from portfolios and did not address, let alone prohibit, portfolio-level evaluation. Our entire focus was on whether NS-PGL’s energy efficiency programs would be generally approved and whether cost recovery via Rider EEP would be allowed. This occurred in the context of a general rate case, in which scores of issues are addressed. The Commission did not specifically consider application of the TRC test at the portfolio level until the following day, in the ComEd and Ameren electric energy efficiency dockets, in which we approved portfolio-level measurement.

F. Whether the Utilities’ Energy Efficiency Expenses Were Prudent

Given the findings and conclusions discussed above, the prudence dispute in this proceeding has been distilled to the following questions, which the Commission addresses in the subsections below.

First, although use of the PAC test was not inherently imprudent when the Chicagoland Program was developed in late 2008, was it nevertheless imprudent to employ that test under then-extant circumstances. Additionally, was that test applied correctly and did the Utilities’ Chicagoland Program pass that test?

Second, although portfolio-level application of the TRC test was not prohibited or inherently imprudent when the Chicagoland Program was developed in late 2008, was it nevertheless imprudent to so employ the test under then-extant circumstances? Additionally, was that test applied correctly and did the Utilities’ Chicagoland Program pass that test?

1. Application of the PAC Test

The Governance Board utilized the PAC test along with the TRC test and “non-monetary factors not ordinarily included in either of the cost-effectiveness tests.”⁴⁹ Those unquantified “non-monetary” factors ostensibly had the potential to “drive down future efficiency costs by raising demand and sales volumes...and improv[ing] service

⁴⁷ ComEd Electric Efficiency Docket, Order, Feb. 6, 2008 at 28 (emphasis added).

⁴⁸ NS-PGL 2007 Rate Order at 183 (emphasis added).

⁴⁹ NS-PGL Ex. 5.0 at 13.

quality.”⁵⁰ The Utilities did not explain how the three evaluative inputs (PAC, TRC and non-monetary factors) were quantitatively interrelated. It is apparent from the totality of the evidence that no mathematical formula was used to weight those inputs. That is both a strength and a weakness of the Board’s approach. Professional judgment was encouraged, but Commission review was made less precise.

Nevertheless, while the interrelationship of the inputs was not quantified, the PAC, by itself, was correctly applied (the Utilities’ PAC computations are undisputed) and the results did establish cost-effectiveness, within the meaning of the PAC, at both the portfolio and measure levels⁵¹. It is possible that the Governance Board over-weighted the PAC, but since the TRC also demonstrated cost-effectiveness at the portfolio level (as discussed in the next subsection of this Order), the results of the PAC test, irrespective of weightings, were not in conflict with the TRC. We therefore cannot conclude that the Board’s use of the PAC was imprudent.

2. Application of the TRC Test

NS-PGL maintains that its efficiency portfolio was cost-effective under the TRC when devised. The portfolio TRC was initially calculated at 1.30 and subsequently revised to 1.61⁵², and either result suggests prudence. Staff does not dispute the accuracy of those calculations as presented, but contends that the Program’s TRC would have been only .99 (*i.e.*, less than cost-effective) if two components of the Utilities’ calculations had been different - first, if the labor cost of wall insulation had appropriately included *contractor* participation and, second, if the *actual performance* of the Program during the reconciliation period had been plugged into the computation⁵³. Staff also suggests that an inflated TRC may have been used for tankless water heaters (which, in turn, would have inflated the portfolio-level TRC) and that assumptions supporting the selection of high-efficiency clothes washers were flawed (again skewing the portfolio’s TRC result).

Regarding Staff’s reliance on *actual* Program performance to challenge the Utilities’ portfolio TRC, the Commission does not, as we said above, employ hindsight in a prudence review. The sole question is whether the Governance Board’s inputs and assumptions were reasonable at the time the Program was developed. The record contains no argument or evidence that the Board’s projections about the *number of rebates per efficiency measure* were imprudent when made, and we will not, during prudence review, replace those projections with actual program performance.

Staff’s criticisms of the reasonableness of the Program’s *cost estimate per unit* of wall insulation, of the TRC used for tankless water heaters and of the assumptions underlying high-efficiency clothes washers are another matter, however. They focus on

⁵⁰ *Id.*

⁵¹ At the portfolio level, the PAC was initially calculated at 3.27, later revised to 2.11. NS-PGL Ex. 4.0 at 7. Each efficiency measure was also individually cost-effective. *Id.* at 3.

⁵² *Id.* at 7.

⁵³ Staff Ex. 3.0 at 19. Specifically, Staff would use the *actual* number of rebates issued per efficiency measure, rather than the *projected* number, in TRC calculations.

the reasonableness, competence and accuracy of TRC estimates *when made*. We will address those criticisms momentarily.

First, however, the Commission notes that Staff's position is not dependent upon whether its objections to NS-PGL's application of the TRC would pull the Program's portfolio-level TRC under 1.0. Staff challenges the notion that portfolio-level TRC cost-effectiveness, by itself, necessarily establishes portfolio prudence. This challenge has multiple permutations: first, that individual efficiency measures with TRC ratios below 1.0 increase the risk that portfolio-wide cost-effectiveness will not be achieved⁵⁴; second, that a nominally cost-effective portfolio can still deprive customers of the benefits of an even more cost-effective portfolio⁵⁵; third, that qualitative or "non-monetary" factors inject excess subjectivity into portfolio construction, despite nominal cost-effectiveness; and fourth, that the rationales and assumptions under-girding a portfolio can be so unreasonable or inaccurate that customers are deprived of benefits or saddled with costs that a prudent efficiency program designer would have foreseen

Again, the Commission does not, in a prudence review, consider whether the alternatives actually chosen were optimal alternatives. Incremental divergence from perfection is not imprudence. Thus, some degree of portfolio risk is not imprudent when the likelihood of realizing other important efficiency objectives is enhanced. Similarly, the most cost-effective portfolio for the short-term may adversely affect longer-run promotion of energy efficiency. Additionally, the distinction between monetary and non-monetary factors is imprecise. For example, while expanded consumer awareness of efficiency options is a non-monetary objective by itself, consumers will not make monetary investments in options they are not aware of. Accordingly, the Commission's role in prudence review is not to punish choices that were merely less than maximally cost-effective in the short term⁵⁶. However, the Commission's role *is* to protect consumers and the marketplace from actions and inactions that were unreasonable when made, from flawed decision-making and acute misjudgment.

Applying the foregoing principles, we now consider Staff's criticisms of the assumptions and calculations supporting NS-PGL's construction of its energy efficiency portfolio.

a.) Tankless Water Heaters

As the name suggests, a tankless water heater uses natural gas to heat water without requiring a storage tank. Water is heated on demand, providing a four-fold increase in energy savings over an ENERGY STAR storage water heater⁵⁷. However,

⁵⁴ Staff IB at 13.

⁵⁵ *Id.* at 12.

⁵⁶ In future energy efficiency reconciliations for natural gas utilities, the Commission will enforce Section 8-104 of the Public Utilities Act, which is inapplicable to the present case. Section 8-104 contains many quantitative principles and requirements that will govern our decision-making. Nothing we say in this Order is intended to construe what is required by Section 8-104.

⁵⁷ NS-PGL Ex. 4.0 at 19.

tankless water heaters are a costlier purchase for the consumer⁵⁸. The Utilities aver that tankless heaters passed the TRC test and were included in the Program to leverage the ENERGY STAR brand, to drive down tankless heater cost through increased market acceptance, and to provide non-monetary benefits (including smaller installation space, immediate hot water and water savings from reduced consumption while waiting for hot water to reach the faucet)⁵⁹.

Staff questions whether tankless heaters were in fact cost-effective when selected. However, even though the TRC for tankless heaters was alternatively quantified at both .78 and 1.01, the latter result was apparently used when designing the portfolio⁶⁰. Thus, tankless heaters individually passed the TRC test at the pertinent time for prudence analysis. Moreover, they did not constitute a large enough segment of the portfolio to meaningfully reduce overall portfolio cost-effectiveness, even assuming, for argument's sake, a TRC of .78⁶¹. Consequently, with respect to the TRC test, there is no apparent basis for an imprudence finding.

Staff adds, though, that almost half of People's service area has a low-pressure system, which cannot support tankless water heaters without a booster, the cost of which was not included in the Utilities' cost-effectiveness analysis⁶². NS-PGL admits that the Program's designers were unaware of this pressure inadequacy when they chose tankless heaters⁶³. However, as Staff acknowledges, even half of Peoples' customer base represents an ample market for energy efficiency measures⁶⁴, and low pressure was not an issue in North Shore's service territory.⁶⁵ Further, there is no evidence that any Peoples customer with insufficient pressure received a rebate through the Program⁶⁶.

Accordingly, the Commission does not find that NS-PGL and the Governance Board acted imprudently by selecting tankless water heaters for the portfolio. Tankless heaters were apparently cost-effective when selected, were accessible by an ample customer base, were a minimal portion of the portfolio and were chosen for sound reasons. Expanding customer acceptance of energy efficiency, with the concomitant reduction in unit price typically associated with mass market acceptance, is a legitimate

⁵⁸ Consequently, the Program's ENERGY STAR-rated *tankless* water heater rebate during the reconciliation period was \$400 per customer, NS-PGL Ex. 2.1, p. 7, while the corresponding ENERGY STAR-rated *storage* water heater rebate was \$140 per customer. *Id.*

⁵⁹ NS-PGL IB at 26.

⁶⁰ Staff Ex. 2.0 at 17; Tr. 94 (Beitel).

⁶¹ The Board projected that 32 rebates would be issued for tankless water heaters, accounting for \$35,840 of incremental costs, in a portfolio with overall incremental costs of \$4,198,384. Staff Ex. 3.0. Attach. A.

⁶² Staff IB at 15.

⁶³ NS-PGL IB at 27.

⁶⁴ Tr. at 247 (Brightwell). In October 2009 (the month for which there is evidence closest to the reconciliation period here), there were approximately 787,000 customers in Peoples' residential service class (SC 1). PGL Ex. 1.1, p. 4.

⁶⁵ NS-PGL Ex. 6.0 at 9.

⁶⁶ Tr. at 119 (Beitel).

and multi-year⁶⁷ objective. This is not to say that the Commission would reflexively endorse every goal labeled “longer-term,” or approve substantial one-year economic losses for consumers, or ratify an ill-conceived market transformation scheme. None of those circumstances are present here, however.

b.) High-Efficiency Clothes Washers

Under the Chicagoland Program, customers received a \$100 rebate for purchase of an ENERGY STAR-rated high efficiency clothes washer⁶⁸. Staff’s principal argument for imprudence is that the TRC ratio for this measure is only .94, so that the rebate exceeds, by .06, the quantitative benefits recognized by the TRC⁶⁹. The Utilities and AG respond that important but non-quantifiable (in the short run) benefits compensated for the relatively minor excess cost quantified by the TRC test⁷⁰. Staff counters that those ostensible unquantified benefits are actually accounted for in the “net-to-gross ratio,” so that the cost-effectiveness deficit identified by the TRC was not mitigated by purported non-quantifiable benefits⁷¹.

The net-to-gross ratio accounts for “free riders” (customers who claim a rebate but would have bought the product anyway) and “spillover” (energy efficiency by customers who did not claim a rebate but were influenced by awareness of the efficiency Program)⁷². In Staff’s view, spillover captures the benefit of expanded market awareness of energy efficiency and (under one interpretation of record evidence) clothes washers had only a .8 net-to-gross ratio (*i.e.*, more free ridership than spillover). However, Staff acknowledges NS-PGL’s assertion that a 1.0 net-to-gross ratio was assumed for all measures in the program⁷³. The Utilities and the AG contend that Staff’s net-to-gross argument is just another manifestation of Staff’s flawed measure-level attack on efficiency choices with TRC results below 1.0⁷⁴.

The Commission does not conclude that placement of high efficiency clothes washers in the Program constituted imprudence. We have already held that it was generally permissible for NS-PGL to rely on portfolio-level calculation of cost-effectiveness, and the Program’s portfolio satisfied the TRC test. With a measure-level TRC of .94, clothes washers neither substantially increased the risk of the portfolio meeting cost-effectiveness objectives nor substantially reduced the overall cost-effectiveness of the Program. Nor were the reasons for including clothes washers ill-conceived.

⁶⁷ “Market transformation occurs over a period of years and in coordination with national and regional efforts rather than one program acting independently.” NS-PGL Ex. 7.0 at 11.

⁶⁸ NS-PGL Ex. 2.1, p. 7.

⁶⁹ Staff IB at 19.

⁷⁰ NS-PGL IB at 29; AG IB at 8.

⁷¹ Staff IB at 20.

⁷² Staff Ex. 2.0 at 11.

⁷³ Staff RB at 9.

⁷⁴ NS-PGL RB at 16; AG RB at 12.

[H]igh efficiency clothes washers were included in the Chicagoland portfolio because the TRC was very close to 1.0...[and] clothes washers provided high visibility to consumers and led to a retail-based awareness of gas efficiency measures, and leveraged the extensive retailer-based outreach and awareness of energy efficiency measures that was already underway in the market through the ComEd energy efficiency program...[C]lothes washers incentives appear regionally and nationally, and are the cornerstone of many energy efficiency programs.

[C]lothes washers were the only significantly visible product in the Chicagoland portfolio. Unlike heating and water heating measures, people touch and see clothes washers several times a week. Moreover, clothes washers have features that can get people excited about efficient products, like using less water and detergent, and causing less wear and tear on clothes...the opportunity to generate consumer excitement about efficiency was a critical factor in the Program team's recommendation to include clothes washers in the Program⁷⁵.

Whether or not these washers were an optimal choice, it was not imprudent to include an oft-used retail product in the portfolio mix. Indeed, if the Governance Board had selected only measures that typically require contractor installation (and perhaps contractor purchase, with resale to the end-use customer), we might well have questioned the exclusion of all items with mass market appeal. Broad enthusiasm for energy efficiency is desirable, both as a means and an end. Staff's concern that virtually any cost-ineffective measure might be approved under a cloak of market "enthusiasm" is certainly valid, but a retail product that almost passes the TRC test by itself, in a portfolio with a positive TRC, is not imprudent in this instance.

Even if we assume, for argument's sake, that a .80 (rather than a 1.0) net-to-gross ratio pertained to clothes washers when selected, the Commission would not find imprudence here. A forward-looking net-to-gross ratio is a projection about matters significantly interlaced with subjectivity and uncertainty (*i.e.*, the relationship of rebates and program awareness to future consumer behavior)⁷⁶. Ironically, it is Staff that complains here about uncertainty and subjectivity⁷⁷. In fact, some degree of subjectivity and uncertainty is inherent in projections about future market activity⁷⁸. Absent patent

⁷⁵ NS-PGL IB at 28-29 (citations omitted).

⁷⁶ Instructively, the utility in the Ameren Gas Efficiency Docket stated that "the net-to-gross ratio is a number calculated based on *post-implementation* evaluation of program impacts." Dckt. 08-0104, Order at 13 (emphasis added).

⁷⁷ *E.g.*, Staff Ex. 3.0 at 19 & 22.

⁷⁸ *E.g.*, NS-PGL Ex. 6.0 at 16.

unreasonableness, the Commission will not premise imprudence on projections by qualified program designers.

c.) Wall Insulation

The Chicagoland Program's customer rebate for wall insulation was 75% of total cost, up to \$750 per home⁷⁹. Wall insulation reduces gas consumption by reducing interior heat loss. The original TRC for wall insulation was 2.5, based on the assumption that customers would have no installation costs. The Board anticipated such do-it-yourself installation because a "rapidly declining economy" in late 2008 had left consumers with "very little disposable income to invest in discretionary spending such as energy efficiency upgrades."⁸⁰ However, by May 2009, the Board realized that about two-thirds of wall insulation rebates involved contractor installation⁸¹. When the Board plugged that greater percentage of contractor installations into the TRC, the result was .70⁸².

Staff challenges the reasonableness of the Board's original do-it-yourself installation assumption for several reasons. First, Staff criticizes the Board for not including the value of the owner's time in the cost of self-installation⁸³. Second, Staff asserts that the Board contradicted its do-it-yourself assumption by including contractors in its trade ally network and providing contractor training⁸⁴. Third, Staff contends that even a brief internet search would have demonstrated to Program designers that ordinary consumers cannot typically retrofit their own walls⁸⁵. Moreover, Staff emphasizes, the Board relied upon 2001-2002 cost-effectiveness information showing *contractor* insulation costs ranging from \$0.82 to \$1.35 per square foot, adding that, "[g]iven inflation, a reasonable person would conclude the price per square foot would be higher in 2008 and 2009[,] a full six years after these installations took place."⁸⁶ As for the Utilities' claimed non-monetary insulation benefits (e.g., customer comfort), Staff contends that NS-PGL should have attempted to quantify and compare such benefits to the true monetary costs⁸⁷.

The Utilities concede that the self-installation assumption for wall insulation was "incorrect" in hindsight, but aver that it was reasonable under the economic circumstances of late 2008⁸⁸. They add that insulation was, in fact, promoted through retailers, as well as contractors, so that there was no contradiction between the Board's

⁷⁹ NS-PGL Ex. 2.1, p. 7.

⁸⁰ NS-PGL IB at 30.

⁸¹ NS-PGL Ex. 4.0 at 24.

⁸² *Id.*

⁸³ Staff IB at 17.

⁸⁴ *Id.* at 16-17.

⁸⁵ *Id.* at 17.

⁸⁶ *Id.* at 18.

⁸⁷ Staff estimates that the true per-customer monetary cost of wall insulation, including labor cost, was approximately \$1200 greater than monetary benefit. Tr. 216 (Brightwell). However, Program rebates were capped at \$750 per customer, *id.* at 229, which is the amount being reconciled in this case.

⁸⁸ NS-PGL IB at 31.

do-it-yourself assumption and its actual outreach. They say that their contractor-related promotions were simply “more successful.”⁸⁹ Furthermore, NS-PGL asserts, the cost of contractor installation would presumably fall over time with higher volume⁹⁰.

The Commission finds that the decision to include wall insulation in the portfolio was unreasonable when made and that it meaningfully reduced the anticipated value of the portfolio to customers. The erroneous wall insulation TRC ratio of 2.5 was derived from flawed and contradictory assumptions, and the Board’s implementation actions suggest that those assumptions lacked credibility even to the Board.

Specifically, while the Program’s designers reasonably assessed the economic distress of late 2008, there is no apparent reason - either in record evidence or in common experience - why a significant percentage of small-volume customers would respond to that distress by self-installing wall insulation. Fully insulating a residence entails opening several walls, safely installing “rigid/wallboard or batting”⁹¹ with appropriate tools and equipment, then patching and painting⁹² (which may necessitate painting large areas for color matching). These steps cost money, yet the Board’s operative premise for customer self-installation was financial constraint. The Utilities response to this apparent contradiction only underscores the weakness of their planning. As the Program’s Contract Administrator testified:

A...We assumed that the wall would be open for some other reason and that we were just talking about adding insulation to the open wall. So what we considered as the likely situation...is that...they were just installing insulation as part of the larger remodeling job.

* * *

Q. And there would be nothing within those [rebate applications] that [would] have incented a customer to install wall insulation in an otherwise closed wall?

A. No. We were not providing that⁹³.

Thus, while the Program’s designers assumed that tight money would limit customer use of contractors for wall insulation, they simultaneously assumed that the same customers would be performing do-it-yourself whole or partial home remodeling. Moreover, the Commission agrees with Staff that wall insulation requires expertise and is a daunting project for many customers⁹⁴. The more comprehensive home remodeling

⁸⁹ NS-PGL RB at 17.

⁹⁰ *Id.*

⁹¹ NS Ex. 2.1 at 7, PGL Ex. 2.1 at 7.

⁹² Tr. 114-15 (Beitel).

⁹³ *Id.* at 116.

⁹⁴ Staff IB at 17.

expected by the Board requires an even broader range of skills. Therefore, it was unreasonable for the Board to assume that customers, despite their financial apprehensions, would nevertheless have the skill, financing and access⁹⁵ to self-remodel their residences (and, in the process, somehow incur zero wall insulation costs). It is hardly surprising that the Program Board contradicted that logic by promoting insulation rebates to contractors anyway. Nor is it surprising that the contractor channel was “more successful” in attracting rebate customers⁹⁶.

Furthermore, as Staff demonstrates, when the designers were selecting efficiency measures for the Program, they reviewed studies that included prior *contractor* installations⁹⁷. There is no evidence that they considered information concerning prior *self*-installations. Nevertheless, they assumed only do-it-yourself installation, on the basis of general concerns regarding prevalent economic conditions. Yet they did not assume that the same economic conditions would impede selection of other efficiency measures that require contractor installation (e.g., tankless water heaters⁹⁸).

To be clear - the Commission’s imprudence finding here has nothing to do with the efficacy of wall insulation as an energy efficiency measure. The Governance Board concluded that a majority of Chicago premises lack insulation and that energy savings and consumer comfort would increase if insulation proliferated⁹⁹. But NS-PGL’s *benefit-cost analysis* for achieving these worthy objectives was starkly flawed. A prudent efficiency program designer would not have assumed zero labor costs for wall insulation. A prudent designer would have included typical labor costs in wall insulation TRC calculations, which would have yielded a less favorable - but substantially more reasonable - benefit-cost ratio. As a consequence, the prudent designer would have either excluded wall insulation from the portfolio (in favor of other measures that would have also increased energy savings and consumer comfort, but more cost-effectively), or would have managed the portfolio to minimize the impact of a cost-ineffective measure¹⁰⁰.

Similarly, the Utilities’ error was not in selecting an efficiency measure with a sub-1.0 TRC result. As we stated above, it was permissible for the Governance Board to evaluate cost-effectiveness at the portfolio level, and it is implicit in that holding that

⁹⁵ In many lessee-occupied premises, lessor permission would be required for do-it-yourself remodeling projects.

⁹⁶ NS-PGL’s claim during litigation that more frequent contractor wall insulation would tend to increase contractor efficiencies and decrease contractor fees, e.g., NS-PGL Ex. 7.0 at 11, is irrelevant. The Program estimated wall insulation costs *with no contractor involvement*. The Utilities cannot credibly argue that the Program’s designers intended to achieve *contractor* installation efficiencies by offering rebate incentives for *do-it-yourself* insulation.

⁹⁷ Staff Ex. 2.0 at 16.

⁹⁸ NS-PGL Ex. 4.0 at 22.

⁹⁹ E.g., NS-PGL RB at 18.

¹⁰⁰ As the Utilities themselves explain: “[P]rogram managers can manage measure mix to manage overall program and portfolio cost-effectiveness, even if the program contains individual measures that do not have a TRC greater than 1.0. For example, program marketing and education activities can focus on those measures expected to yield the greatest returns.” NS-PGL Ex. 6.0 at 17.

measures with a TRC below 1.0 might be included for sound reasons. But just as a utility is responsible for computational errors that distort the estimated cost-effectiveness of a portfolio, so, too, is it responsible for judgment errors that cause such distortion. Ratepayers are entitled to the cost-effectiveness associated with reasonable and prudent decision-making.

G. Disallowance Calculation

Having concluded that costs associated with wall insulation were imprudently incurred, the Commission must quantify an appropriate cost recovery disallowance. Staff recommends *complete* disallowance of wall insulation costs, on the ground that “[t]here would have been no expenses and investments incurred on rebates for...wall insulation absent the imprudence on the part of [the Utilities].”¹⁰¹ The Utilities reply that, at most, only the *incremental costs related to imprudence* should be disallowed, with other wall insulation costs approved for recovery. They argue that disallowance of all wall insulation costs would contravene our ruling in a 1994 case¹⁰². Staff contends that its recommendation is consistent with that ruling.

NS-PGL accurately summarizes the pertinent events and Commission holding in the 1994 case, CILCO:

Staff there proposed to disallow the incremental portion of the amounts spent by the utility that were due to imprudence, and the Commission agreed that that was the correct measure of the disallowance. [Citations omitted]. The Commission expressly rejected an intervenor’s contention that the entire amount spent (apart from a certain amount already scheduled to be spent), rather than the incremental amount spent due to the imprudence, should be disallowed....¹⁰³

The Utilities aptly support their summary by quoting what we agree is dispositive language for our purposes here: “[t]he Commission concludes that the disallowances should be imposed only to the extent that the expenses and investment exceed the levels that would have been incurred absent imprudence on the part of CILCO.”¹⁰⁴

The remaining questions, then, are whether costs associated with imprudence can be separated from other costs and, if so, how they should be quantified. With respect to the first question, the Commission concludes that the cost of imprudence can be detached from reasonably incurred costs. The imprudence here consists of faulty assumptions about the cost of wall insulation, which caused the program to deploy a

¹⁰¹ Staff RB at 12.

¹⁰² *In re Central Illinois Light Co.*, Docket 94-0040, 158 P.U.R. 4th 1, 1994 Ill. PUC Lexis 577, Order, Dec. 12, 1994 (“CILCO”), cited in NS-PGL IB at 33.

¹⁰³ NS-PGL IB at 33.

¹⁰⁴ *Id.* at 33-34.

portfolio with less cost-effectiveness than the Governance Board anticipated - and less cost-effectiveness than reasonable decision-making would have produced. Thus, the difference between the monetary benefit actually generated and the monetary benefit that would have likely been generated by reasonable decision-making constitutes the ratepayer loss due to imprudence.

Regarding quantification of this loss, the monetary benefits actually generated by wall insulation are clearly established by record evidence - each dollar spent yielded \$.70 in monetary benefits (based on an actual insulation cost, including labor, of \$1.22 per square foot, rather than the original and erroneous estimate of \$.35 per square foot).¹⁰⁵ The likely net monetary benefit that reasonable decision-making would have generated are less clear. Within the context of designing an energy efficiency portfolio, there would be a range of estimated per-measure outcomes that would be reasonable. However, it would be unproductive to prolong and complicate this administrative litigation by attempting to map out the boundaries of that range¹⁰⁶. The Utilities suggest using 1.0, the break-even point in the TRC test¹⁰⁷, and the Commission will adopt that suggestion. It provides a readily understandable surrogate quantification of the likely outcome of reasonable efficiency planning. Given the relatively small amounts involved here¹⁰⁸, it is sufficient to approve recovery commensurate with the benefit actually provided (70% of costs incurred), while disallowing recovery of remaining costs¹⁰⁹. That is a satisfactory, workable and warranted substitute for additional efforts that would produce, at most, a trivially different disallowance calculation.

On exceptions, Staff posits that the foregoing methodology will enable NS-PGL to recover even more than they expended on wall insulation¹¹⁰. That is incorrect. The Commission is not approving recovery of 70% of the funds expended *by customers* for wall insulation. Rather, we approve recovery of 70% of wall insulation rebates the Utilities *paid to customers*. The rebates are what flow through Rider EEP and must be reconciled in these dockets. Customer payments to contractors and retailers (whether or not they exceeded the \$750 rebate ceiling) do not flow through Rider EEP. Perhaps Staff is confused because we are employing the break-even point of the TRC test (1.0) to quantify the hypothetical outcome of reasonable energy efficiency planning. We are doing that, however, solely to avoid wasting resources on developing a disallowance quantification methodology that would yield no discernible monetary impact for

¹⁰⁵ NS-PGL Ex. 4.0 at 23-24. To preclude misinterpretation, we note that using actual costs to quantify ratepayer losses is not comparable to using hindsight to evaluate prudence. As in CILCO, it is only *after* finding imprudence without hindsight that we look to actual results to quantify losses.

¹⁰⁶ Even if we embarked on such analysis, we would not rely on the hindsight conjecture of an NS-PGL witness that the Board would have estimated that no more than one-third of customers would have used contractor insulation. NS-PGL Ex. 6.0 at 16.

¹⁰⁷ NS-PGL IB at 34.

¹⁰⁸ The *total* wall insulation rebates for Peoples Gas and North Shore, respectively, were \$52,720 (rounded) and \$12,184 (rounded), Staff Ex. 2.0 at 16, with seventy cents of each dollar prudently expended.

¹⁰⁹ NS-PGL agrees with our rationale for adopting their suggested disallowance quantification methodology, but only for this specific proceeding, while “reserv[ing] their rights in future proceedings involving this issue.” NS-PGL BOE at 12. The Commission acknowledges this reservation.

¹¹⁰ Staff BOE at 9.

ratepayers or the Utilities. We are not endeavoring to make customers whole for the entirety of their commercial insulation expenses, which we have no authority to do in this reconciliation case.

In sum, seventy cents of each dollar spent on wall insulation are approved for recovery in this proceeding (\$8,529 for NS and \$36,904 for PGL). All wall insulation costs exceeding that amount are disallowed.

IV. FINDINGS AND ORDERING PARAGRAPHS

The Commission, having considered the entire record herein and being fully advised in the premises, is of the opinion and finds that:

- (1) North Shore is an Illinois corporation engaged in the sale and distribution of natural gas to the public in Illinois, and is a public utility as defined in Section 3-105 of the Public Utilities Act;
- (2) Peoples Gas is an Illinois corporation engaged in the sale and distribution of natural gas to the public in Illinois, and is a public utility as defined in Section 3-105 of the Public Utilities Act;
- (3) the Commission has jurisdiction over North Shore and Peoples Gas and the subject matter of this proceeding;
- (4) the recitals of fact and conclusions of law set forth in the prefatory portion of this Order are supported by the evidence of record and are hereby adopted as findings of fact and conclusions of law; the Appendices attached hereto provide additional supporting calculations;
- (5) the applicable period in the instant Rider EEP reconciliation proceedings is May 1, 2008, through June 30, 2009;
- (6) the Commission approves the Utilities' Statements of Activity for the applicable period;
- (7) the costs incurred by the Utilities under Rider EEP were prudently incurred, except for certain costs associated with wall insulation, as described and quantified in this Order;
- (8) the Commission approves the Utilities' Statement of Reconciliation Adjustments as to SC No. 1 and SC NO. 2 for the applicable period, as revised to reflect the cost disallowance required by this Order;
- (9) for the period from May 1, 2008, through June 30, 2009, North Shore prudently incurred Rider EEP program expenditures of \$398,803.92; and
- (10) for the period from May 1, 2008, through June 30, 2009, Peoples Gas prudently incurred Rider EEP program expenditures of \$1,654,347.25.

IT IS THEREFORE ORDERED that the reconciliations submitted by North Shore and Peoples Gas of the energy efficiency measures and associated costs actually incurred with the revenues received under Rider EEP covering the period beginning May 1, 2008, and ending June 30, 2009, as to SC No. 1 are hereby approved, subject to the cost disallowance required by this Order;

IT IS FURTHER ORDERED that the reconciliations submitted by North Shore and Peoples Gas of the energy efficiency measures and associated costs actually incurred with the revenues received under Rider EEP covering the period beginning May 1, 2008, and ending June 30, 2009, as to SC No. 2 are hereby approved;

IT IS FURTHER ORDERED that Statements of Activity submitted by North Shore and Peoples Gas for the period beginning May 1, 2008, and ending June 30, 2009 are approved.

IT IS FURTHER ORDERED that, subject to the provisions of Section 10-113 of the Public Utilities Act and 83 Illinois Administrative Code 200.880, this Order is final; it is not subject to the Administrative Review Law.

By Order of the Commission this 15th day of March, 2011.

(SIGNED) DOUGLAS P. SCOTT

Acting Chairman